

Service Date: January 27, 2003

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * * *

IN THE MATTER of the Application)	
of NORTHWESTERN CORPORATION for)	UTILITY DIVISION
Authority to Consummate a Credit Agreement)	
and Issue \$390 MILLION in Principal Amount)	DOCKET NO. D2002.12.159
of Secured Long-Term Notes in the Form of)	
First Mortgage Bonds)	ORDER NO. 6474a

FINAL ORDER

1. On December 23, 2002, NorthWestern Corporation (“NorthWestern” or “Applicant”), a Delaware corporation authorized to transact business within Montana, filed with the Montana Public Service Commission (“Commission”) its application (“Application”) pursuant to §§ 69-3-501-507, MCA (2001), seeking an order authorizing Applicant to perform its obligations under a certain Credit Agreement and the related transactions contemplated by the Credit Agreement whereby long-term notes in the form of first mortgage bonds (the “First Mortgage Bonds”) are to be issued over a period beginning with the issuance of the applicable Commission Order and, unless extended, through and including December 31, 2004 (the “Transaction”), and which provides that the loan proceeds shall be placed in escrow and cannot be accessed by or disbursed by the Applicant without the Commission approval of the Transaction.

2. The Application is supported by exhibits and data in accordance with Commission practice and rules and regulations governing the issuance and sale of securities by public utilities operating within the State of Montana.

3. The Commission is required to consider applications for the issuance of securities within 30 days of the application being filed as set forth at § 69-3-503, MCA. There is a provision in that section that consideration of an application may be extended. In this Docket the Commission extended the time for consideration of this application by an additional 30 days. Proper notice of this filing was provided on the agenda for the

Commission's regularly scheduled business meeting held on January 6, 2003. No requests for intervention were received by the Commission in this Docket.

4. The Application states that Applicant is a public utility as defined at § 69-3-101, MCA, in that it furnishes electric and natural gas service in the State of Montana through NorthWestern Energy, a division of NorthWestern; that its principal executive office for its Montana operations is at 40 East Broadway, Butte, Montana; and that Applicant is duly qualified to do business in the State of Montana. For detailed information with respect to the general character of NorthWestern's business and the territory served by it, reference is made to the Application.

FINDINGS

1. Applicant is a corporation organized and existing under and by virtue of the laws of the State of Delaware and is qualified to transact business in the State of Montana.

2. Applicant is a public utility as defined at § 69-3-101, MCA, and is engaged in furnishing electric and natural gas service in the State of Montana through its division, NorthWestern Energy.

3. The Commission has jurisdiction over the subject matter of the Application pursuant to §§ 69-3-501-507, MCA. The Commission has jurisdiction over the entire \$390 million of financing contained in the Application. The Commission historically addresses security issues in their entirety and again in this Docket will consider the entire amount of financing being contemplated by NorthWestern. Further, the Commission must evaluate all financing activity given the serious nature of the challenges now faced by NorthWestern.

4. The Application states that Applicant intends to issue and, potentially sell, First Mortgage Bonds. The First Mortgage Bonds will be issued under an indenture covering its Montana utility asset in the amount of \$280 million (the "Montana Bonds") and under an indenture covering its South Dakota and Nebraska utility assets in the amount of \$110 million (the "South Dakota Bonds"). As detailed in the Application, the Montana Bonds will be either (i) issued to a Collateral Agent to secure term loans under a new credit facility; and/or (ii) syndicated in a private placement to qualified institutional

buyers. The Montana Bonds (i) will be issued under and secured by the Mortgage and Deed of Trust dated October 1, 1945 from the Applicant to the trustees named therein, as supplemented from time to time, which indenture creates a general and first priority lien on substantially all of the Applicant's utility property in Montana, (ii) will be for terms of not less than nine months nor more than forty years, (iii) will have such redemption and/or repayment provisions as shall be determined at the time of sale, and (iv) will bear interest payable at such times and rates as shall be determined at the time of sale, all based on then-existing market conditions.

5. The Application states that the Montana Bonds will secure term loans which will replace an existing \$280 million credit facility as soon after the effective date of the Commission's Order as possible. It further states that the term loans secured by the Montana Bonds will be used for general corporate purposes allowed under § 69-3-501, MCA.

6. Applicant has agreed to inform the Commission, after the issuance or sale, of the principal amount sold, the maturity, the interest rate, the redemption and/or repayment provisions and any other information with respect to the bonds that the Commission may request.

7. Public notice of this Application was given by its inclusion on the Commission's Utility Division Agenda for January 6, 2002. Applicant has furnished complete financial data with its Application in accordance with the developed practice of the Commission. The Application sets forth a certified copy of the resolution of the Board of Directors of Applicant pertaining thereto, which was adopted on December 12, 2002.

8. On December 20, 2002, Moody's Investors Service downgraded the debt ratings of NorthWestern senior secured to Baa3 from Baa1. Moody's indicated that it, "is continuing to review the long-term ratings for possible further downgrade, where they were placed August 1, 2002. This downgrade included ratings on obligations of the former NorthWestern Energy L.L.C., which became direct obligations of NorthWestern Corporation effective November 20, 2002 when the former subsidiary of NorthWestern was folded into NorthWestern's already existing utility division. The ratings downgrades reflect concerns about considerably less debt reduction to date than anticipated, as well

as weaker than anticipated cash flow relative to the consolidated debt load and fixed obligations.” Moody’s further stated, “The ratings downgrades also reflect NorthWestern’s recently announced expectations for lower than expected earnings and cash flow for 2002 due to ongoing challenges and disappointing results at NorthWestern’s nonutility operations. Those operations are Expanets, the telecommunications solutions business, and Blue Dot, the heating, ventilation and air conditioning service business.” Moody’s noted that “NorthWestern recently announced that it is anticipating a significant increase in reserves for accounts receivable and billing adjustments at Expanets, as well as substantial non-cash writedowns of goodwill and intangibles related to Expanets and Blue Dot. The full extent of the goodwill and intangible asset impairment will be determined in conjunction with the year-end audit which will be completed over the next several months.” Moody’s is continuing to review all of NorthWestern’s long-term ratings for possible further downgrade due to uncertainties surrounding the amount of the expected asset impairment and the impact that action will have on NorthWestern’s balance sheet. At the time of this writing the Commission is unable to evaluate the magnitude of the asset impairment because the year-end audit is not complete. Finally, Moody’s noted that “absent access to the funds under the new CSFB facility—which would facilitate termination of the existing \$280 million facility—the recent announcement related to expected non-cash charges could jeopardize NorthWestern’s ability to remain in compliance with some of the financial covenants in that facility.”

9. On December 30, 2002 Standard and Poor’s Ratings Services lowered its corporate credit rating on NorthWestern to BB+ from BBB+, and at the same time assigned its BBB- rating to NorthWestern’s \$390 million secured four-year bank loan and other senior secured debt. The ratings outlook remains negative. S&P stated that NorthWestern has about \$1.7 billion in outstanding debt. S&P explained that “The downgrade is the result of the several problems facing NorthWestern Corporation, including a deteriorating balance sheet, continued poor performance in its Expanets and Blue Dot subsidiaries, and management’s inability to adequately project the performance of the non-regulated businesses.” S&P indicated that the financing plan for the Montana Power acquisition in early 2002 included \$200 million of equity, to be issued in the first quarter of 2002. NorthWestern did issue about \$83 million of equity in September 2002,

but given the company's current stock price (\$5.51 on January 22, 2003) of half its book value, and general equity market conditions S&P does not believe that the company will issue additional equity in the foreseeable future. Instead, NorthWestern may potentially incur additional debt to substitute for equity issues. A new \$390 million credit facility will be used to replace existing NorthWestern bank loans and fund capital expenditures at the utilities, will give the company additional liquidity, but will further weaken coverages for debtholders. S&P is also concerned about the performance of NorthWestern's non-utility businesses, specifically Expanets and Blue Dot.

10. On January 16, 2002 Fitch rating service downgraded NorthWestern's senior unsecured notes and pollution control revenue bonds from BBB to BB+, the highest junk status Fitch has. Preferred stock and trust preferred securities for NorthWestern were also downgraded from BBB- to BB+. Secured debt with senior status was lowered from BBB+ to BBB- which is the lowest Fitch rating that still is investment grade. According to Fitch, NorthWestern's debt and preferred shares total \$1.9 billion. The utility division's fixed assets carry a book value of \$1.6 billion. That means NorthWestern's book value is less than the corporation's debt. Factors in the downgrades were NorthWestern's high debt, expected writeoffs against earnings this year and marginal performance at Expanets and Blue Dot. Fitch did indicate that "The utility is strong and has good cash flow, but despite that, there is a lot of debt at the parent company."

11. On January 9, 2003, NorthWestern filed a letter which set forth the nature of the draws against the current credit facility. Non-utility activities accounted for \$114 million of the \$276 million expended through December 31, 2002. Montana First Megawatts (MFM), the proposed combined cycle gas plant in Great Falls drew \$61 million, Expanets drew \$37 million, Blue Dot contributed \$10 million on a net basis, and CornerStone Propane drew \$26. The new credit facility permits additional funds of \$25 million to Blue Dot and \$75 million to Expanets.

12. The Commission views the financial condition of NorthWestern with great concern. The Commission approved NorthWestern as the purchaser of MPC's transmission and distribution systems. Since that approval the financial condition of NorthWestern has spiraled down due to non-utility activities at CornerStone Propane, Expanets

and Blue Dot. The Commission is dismayed at the erosion of NorthWestern's credit ratings to either the lowest investment grade or to junk status. The performance of the non-utility entities and the resulting threats to the provision of utility service is unacceptable to this Commission. The cost of borrowing money has been increased due to losses at the non-utility companies. In its January 9, 2003 letter, noted above, NorthWestern stated "It is the company's intent to move in the direction of a pure energy distribution business." The Commission finds that the company's intention to become a pure utility company is the proper course of action. The Commission directs NorthWestern to devote its management to making sure that the company focuses all of its resources on changing its strategic direction in a timely manner. As was noted in the comments of the rating agencies, it is imperative that NorthWestern take timely action to reduce the amount of debt in the company's capital structure.

13. During its review of this filing the Commission became aware of an incentive program adopted by the company in September 1999. The program was one in which certain key executives of NorthWestern and key team members NorthWestern Growth Corporation, which initiates strategic investments for NorthWestern, were provided the opportunity to make personal investments. The investment entity was structured as a limited liability company, is controlled and substantially owned by NorthWestern, and enables the investors to participate in long-term capital appreciation resulting from increases in the value of NorthWestern's interests in Blue Dot, Expanets and CornerStone above benchmark rates of return to NorthWestern approved by the independent Compensation Committee of NorthWestern's Board of Directors. The limited liability company has no indebtedness and is consolidated in NorthWestern's financial statements. No losses of these subsidiaries have been allocated to the minority interest owned by the limited liability company. In the year ended December 31, 2001, the following executive officers of NorthWestern received distributions Merle Lewis \$1.1 million; Richard Hyland \$.8 million; Daniel Newell \$.8 million; Eric Jacobsen \$.4 million and Kipp Orme \$.1 million. This recruitment and retention program is no longer being utilized to provide long-term equity incentives and is no longer open to new participants, although the pre-existing interests of the participants remain outstanding. The Commission finds that this Long-Term Equity Incentive Plan is completely

inappropriate and directs NorthWestern to refrain from making any further payments under the plan until NorthWestern's financial condition has dramatically improved. Any future incentive plans for key executives must be approved by the Commission before they are adopted.

14. Questions about accounting practices at NorthWestern have appeared in a number of comments by analysts and others. NorthWestern has decided to discontinue recording income from minority interest. The Commission finds that NorthWestern should follow Generally Accepted Accounting Principles and take all necessary steps to ensure that its accounting records properly reflect the true results from each segment of the company in a manner that is transparent and easily understood.

CONCLUSIONS OF LAW

1. NorthWestern Energy is a public utility in Montana subject to the supervision and regulation of the Montana Public Service Commission. §§ 69-3-101-102, MCA.

2. NorthWestern Energy is a division of NorthWestern Corporation. NorthWestern Corporation is subject to §§ 69-3-501-507, MCA, for purposes of the action it proposes in this Docket.

3. The Transaction proposed by the Application, as hereinafter authorized, will be for a lawful purpose and is consistent with the public interest; is necessary or appropriate for and consistent with the proper performance by Applicant of service as a public utility; and the aggregate amount of the securities outstanding, and proposed to be outstanding, will not exceed the fair value of NorthWestern's utility properties and business of Applicant.

ORDER

1. The Application of NorthWestern for authority to consummate the Transaction and to issue secured long-term notes in the form of the First Mortgage Bonds is approved with the conditions noted below. This authorization is for a period beginning with the issuance of this Order and, unless extended, through and including December 31, 2004.

2. In accordance with § 69-3-507, MCA, neither the issuance and sale of securities by NorthWestern pursuant to the provisions of this Order, nor any other act or deed done or performed in connection therewith, shall be construed to obligate the State of Montana to pay or guarantee, in any manner whatsoever, any security authorized, issued, assumed or guaranteed under the provisions of §§ 69-3-501-507, MCA.

3. Issuance of this Order does not mean acceptance of NorthWestern's exhibits or other material accompanying the Application for any purpose other than the issuance of this Order. Approval of this application is for financing purposes only. This approval is without prejudice to the regulatory authority of this Commission with respect to ratemaking, rates, service, accounts, valuations, estimates or determinations of cost, or any other matter subject to its jurisdiction as provided by law.

4. Because the Commission has continuing concerns about the performance and prospects of Applicant's non-utility businesses, and the implications of their financial performance for utility customers, the following conditions are expressly added to this Order.

5. NorthWestern Corporation has indicated it is exploring its options with regard to any of its non-utility entities, specifically including Blue Dot and Expanets. When a sale in whole or in part of any non-utility entities is completed the proceeds shall be as expeditiously as possible applied to debt reduction.

6. NorthWestern Corporation's loan agreement allows the company to make additional equity investments in its subsidiaries of no more than \$10 million over the five-year term of the agreement. Additionally, under the new loan agreement, secured loans of up to \$25 million to Blue Dot and up to \$75 million to Expanets are allowed by the lender.

7. The Commission understands that NorthWestern may need to make limited capital available to the subsidiaries to ensure their viability while it completes its examination of alternatives for these entities. However, the Commission does not favor additional financing of the subsidiaries since further investments in the subsidiaries may not be in the best interests of utility customers.

8. The Commission recognizes that NorthWestern Corporation's board of directors and management are responsible to prepare and implement a strategic workout

plan to resolve the financial crisis precipitated by a series of corporate decisions, non-utility ventures, poor performance, and acquisitions. The crisis did not develop overnight, and it will not be resolved overnight. Nevertheless, the Commission's outlook is negative, mirroring that of rating agencies. Neither NorthWestern's actions nor information presented to date allay the concerns.

9. The Commission is primarily responsible to ensure that regulated energy services provided to Montana consumers are safe, adequate and reliable at rates that are just and reasonable. NorthWestern's ability to fulfill these requirements is placed at risk by its current financial condition. Serious questions exist about the ability and commitment of NorthWestern to pursue adequate and necessary maintenance, repair and replacement of critical utility infrastructure when potential bankruptcy and survival occupy the attention of the board of directors and management. Approval of this security application requires ongoing commitment to fully fund comprehensive operation, maintenance, repair and replacement of its public utility infrastructure in Montana. NorthWestern must file a maintenance plan and budget within 45 days of the issuance of this Order.

10. By approving this security application, subject to the conditions contained in this Order, the Commission is not satisfied that NorthWestern has pursued all available options for digging out of the financial crisis which threatens utility service quality and rates. The Commission expects the board of directors and management, to fully examine all options, including but not limited to: dividend policy and payouts; board of directors and senior management compensation levels and concessions; disposition of non-utility assets/operations; and sale of the Montana First Megawatts project, or a portion thereof.

11. Without prior approval from the Commission, NorthWestern may, if it deems it necessary, provide up to an additional \$10 million in capital to any non-utility entities. However, the Commission expects NorthWestern's management to exercise this authority with the utmost caution and to first ensure that all steps are being taken within these subsidiaries themselves to minimize the need for external resources. NorthWestern must report all advances to non-utility companies within 5 business days of the advances to this Commission.

12. If existing credit agreements for Blue Dot or Expanets are terminated NorthWestern may file an application with the Commission seeking approval to provide secured loan agreements not to exceed \$20 million for Blue Dot and \$30 million for Expanets.

DONE IN OPEN SESSION at Helena, Montana, this 24th day of January, 2003,
by a vote of 4 to 1.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

BOB ROWE, Chairman

TOM SCHNEIDER, Vice Chairman

GREG JERGESON, Commissioner

MATT BRAINARD, Commissioner
Voting to Dissent, Opinion Attached

JAY STOVALL, Commissioner

ATTEST:

Rhonda J. Simmons
Commission Secretary

(SEAL)

Note: Any interested party may request that the Commission reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.4806, ARM.

Dissenting Opinion of Commissioner BrainardDocket No. D2002.12.159

As restrictive as the order may appear to some, it does little to retain the needed firewall between the utility and non-utility operations of the applicant. Certainly there is no reciprocity available to the utility and its customers to advantage themselves of the assets of the non-utility businesses, even if those businesses were financially robust and able. It is most certain that the Commission would not, could not, and should not ever order the use of non-utility assets to benefit the ratepayers.

The Commission has a duty to see that the utility owner lives up to legitimate obligations to manage the utility assets in a way that is not detrimental to the customers and the public interest. While it may be lawful for the company to have multiple business interests including utilities and non-utilities, a wall of separation should exist and business affairs should be conducted in a manner that insures that separation.

The applicant has presented the Commission with a "fait accompli" by using part of the credit facility used in the purchase of MPC to finance non-utility ventures. Now that it is time to restructure the credit facility the Commission is asked to sanction the use of utility assets to secure the debt of the non-utilities as well. This has been presented to the Commission as a unique event, the applicant is in desperate financial conditions and the utility itself is threatened by the conditions that face the applicant.

The Commission should not succumb to the exigency of imminent crisis and establish precedent that will undoubtedly be visited in the future. The non-utility businesses are beyond the regulatory scope of the Commission. Profits, losses or catastrophic failures of non-utility operations are beyond regulatory reach, hence regulated assets should not be tendered as security for those business ventures.

RESPECTFULLY SUBMITTED this 24th day of January, 2003.

Matt Brainard, Commissioner
District #4